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Pondering Corporate Social Responsibilities of Bankers regarding Reverse Convertible Bonds

Key words: Financial ethics, speech acts, trust, SRI, reverse convertible bonds, information asymmetry.

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Abstract

How is a socially responsible investor to judge banks and financial instruments? The scope for social responsibility in finance is extremely wide: finance is everywhere. Bankers perform a difficult and troublesome profession. Their reputation and "corporate social responsibility" (CSR) are constantly under pressure and sometimes vigorously attacked. Financial intermediation is not only an activity that by its intrinsic complexity and intermediating function within the economy easily arouses distrust. It is also susceptible to different paradigms. Some consider financial intermediaries as politicians that shape our future for better or for worse by providing or not providing funding to real world projects; in this view, bankers discharge their social responsibility by directing the economy towards ecological and social goals. Others consider financial intermediation as professional management of trust in the context of information asymmetry; in this view, bankers discharge their social responsibility by generating and earning trust. This article covers both views on the corporate responsibility of banks, focussing on the intermediation that is entailed in the construing and distributing of "reverse convertible bonds".

We probe into the nature of the curious financial structures that go by the name "reverse convertible bonds". We model these structures as speech acts that can performed in different manners and we review possible strategies and tactics in distribution by retail bankers. We suggest how they can show superior corporate responsibility and diminish the reputation risk that originates in the information asymmetry between banker and customer. That analysis covers the paradigm of bankers as professional managers of trust. We then treat the other paradigm by looking at ecological and social aspects of the matter. We find that the first paradigm is pertinent for the socially responsible investor whereas the political paradigm is not.

Authors[1]

1. Introduction

Banking in the largest sense of the word, sc. the professional activity of money handling, is not an easy and more often than not a rather unpopular profession. In his lecture on financial ethics, Amartya Senn takes the "dissonance between the low image of the practice of finance and the high social contribution it undoubtedly makes" as his point of departure (Sen, p.26). Even *The Wall Street Journal* – a paper that can hardly be suspected of hostility towards business in general and finance in particular – at times publishes discourse charged with heavily negative moral tone: excessive greed, foolish risk taking by the shenanigans of financiers caused the current global crisis (Dixon & Goldfarb, p.19). The discipline of finance itself is often represented as obnoxious and harmful and irresponsibly post-modernistic, even by knowledgeable observers (e.g. Prodhan, pp.4-7). This may be due to the fact that the discipline is relatively young and not yet fully understood and absorbed (cf. Kritzman). Also, dissatisfaction with free markets and capitalism in general may provoke such reactions: "As capitalism's high priesthood, the financial community may hope to be admired and even appreciated, but it cannot expect to be loved. Financial institutions do not make friends easily.", as Christopher Cowton aptly observes (p.213). Suspicion of or antipathy towards this essential and pivotal economic activity is so deep that, in the late 1980's, 70 out of 125 customers of the information provider EIRIS, so called "ethical investors" or "socially responsible investors", categorically shunned investing in financial institutions (ibidem, p.219). This, of course, is utter nonsense and unsustainable, because without banking an economy is can not develop or even function. If anything, the current financial crises show that good banking is elementary for a good functioning of the economy.

One of the reasons for not being very popular is mistrust of the profession that seems to be corroborated time and again. Indeed, whenever bubbles inflate and consecutively come to bust, always bankers are involved. People tend to believe that bankers have superior knowledge about what is going to happen to financial and economic variables

[1] The authors like to thank W. Vandekerckhove, Chr. Cowton, H. Lasat, L. Rasschaert, C. Gijselinckx and L. Van Liedekerke for their valuable comments on earlier draft. In order to be eligible for publication in reviews, the text has to be trimmed and the dosage of innovative elements should be lessened. Moreover, the public that is interested in finance (RCB) and in ethics as well is a rather small target. This entails that the position of co-author is really open, either for a fellow academician who focuses on organization ethics or for a fellow academician who focuses on information asymmetry or on deontology of banking.

and, in general, what course the future will take. After all, they have studied at universities, are well paid and they issue forecasts continuously.[2] In a sense, this believe is obviously true: bankers are insiders and bankers operate with those variables on a daily basis whereas customers only occupy themselves with those variables if and when the necessity arises (e.g. when an investment reaches maturity) or a compelling opportunity presents itself (e.g. a heritage). In another sense, this can absolutely not be true because no human being has superior access to the future. To be able to distinguish which of both applies in a particular case requires considerable intellectual energy. Was the bankers' forecast wrong or did he *cause* the bubble? This permanent ambiguity, by itself, is a driver of mistrust and makes the profession a morally hazardous one. An additional circumstance that contributes to suspicion is that bankers are in business to make a profit – which is widely, albeit not universally, considered to be very legitimate by itself, but may be the source of conflicts of interest when the banker is in an agency relation with his customer.[3]

Moreover, financial 'products' have a particular nature that makes them difficult to judge and valuate at the moment of purchasing. A first difficulty arises out of the fact that all financial constructs are immaterial and take their course over time and that they are not 'used' or 'consumed' by the purchaser. Financial 'products' or 'services' are therefore less easy to valuate by customers than material products, such as an I-pod, a light bulb or a shirt. In fact, financial constructs can be considered as mere speech acts that are

[2] So do astrologists. Astrologists sometimes happen to predict correctly but that fact does not make them more knowledgeable about future events. The financial industry is partly a forecasting business and in this capacity celebrates temporary heroes who correctly predicted events. After the facts, it is always possible to find a forecaster who predicted it. But the subprime-mortgage crisis in the VS was, as late as 2006, alarmed for by only a tiny minority that did not receive attention from other forecasters. Yet, predicting that the mass of borrowers who display bad credit risk and insufficient cash flow is unlikely to honor its contracts over time, is not that risky to predict. While continuously spouting forecasts, bankers themselves know that "He who lives by the crystal ball soon learns to eat ground glass". So, what we will not do in this article is judge or second guess forecasts regarding investment bets – there is no point for ethicists to do so. In general, we know that some will go down and some will go up; only with hindsight, one is able to identify them with certainty and beforehand one can only speculate. Ethicists occupy themselves not with the eventual outcomes but with the speech acts that constitute the products in the process of engineering and selling the instruments.

[3] When introducing the concept of agency (and its complement, that of the principal) business ethicists usually give two kind of examples: the agency relationship of the medic with the principal, sc. the patient, and the agency relationship between corporate management and shareholders (e.g. Dees, p.25; p.28). In the case of banking as a business activity, both agency relationships exist. The one ensues from corporate structure, the other originates in the information asymmetry between the professional (the doctor, the banker) and the client (the patient, the retail investor / borrower). This article treats them both; the first as the question about investing in "socially responsible banks", the second as the question about intermediating the stock risk through the sales of RCB s.

infused with a little bit of mathematics (and accountancy) and that come in a well developed legal shell. The purchaser participates in financial constructs whereas customers of shirt-producers do not participate in the production of the shirt. In finance, participants construe the 'product' together. As such, financial constructs can be deconstructed or analysed as more or less complex chains of promises, guarantees, predictions, warnings, invitations, threats, descriptions, and so on, which is more difficult as it seems, due to complexity of the mathematics involved[4], to the legal and financial jargon. A second difficulty is that the customer often is unaware about the professional capacity or purpose of the banker he is interacting with when managing his personal finance. Research commissioned by the SEC early 2008 shows that retail investors are confused about the difference between brokers and financial advisors (Pessin 2008).[5] The customer exchanges speech acts with an interlocutor whose interests he does not grasp.

Those difficulties are to be typified as information asymmetries: the customer of the financial industry is less knowledgeable about finance than the providers are and this information asymmetry pertains to role-distinctions, to actual offerings and to general background. In fact, it pertains to nearly all features and aspects of financial business. The information asymmetry constitutes a source of distrust and moral risk for the banker: afterwards he is liable to be reproached or even accused of wrongdoing by withholding information, by not stating in clear and simple terms what it was all about and so on. That risk is always triggered by financial constructs not performing according to the *expectations* of the customer: accusations of wrongdoing and misleading abound when stock markets go down, interest rates go up and spreads widen (cf. Boatright, p.63). Investors get unhappy and worried by these events. They loose trust. The temptation to accuse the banker grows with these sentiments and with the depth of the information asymmetry. Customers that are completely ignorant may accuse the banker to have simply stolen a part of the initial portfolio; more subtle customers link the profit motive

[4] Illiteracy in mathematics is by itself a source of problems because it may be exploited by way of "a common investment ploy" regarding investment returns (Kritzman, pp.140-142) or to trick customers into transactions that diminish their net present value by selling them unneeded loans (Leys 2009). In this article, we will disregard mathematics as much as possible.

[5] When one would remark that these findings may be explained by Americans investing far less than they take out in loans and thus being more indifferent when it comes to investing, we riposte by referring to the recent survey commissioned by the *Consumer Federation of America* and *Washington Mutual Inc*. The survey showed an astonishing lack of consumer knowledge about credit scores and how to manage credit lines prudently. This illiteracy prevents the American customer from saving an estimated $ 28 billion annually (Waters 2008). Nor is this lack of competence typical for Americans. It is endemic in other nations and cultures too.

with the way they feel to have been treated. Whether reproaches or accusations are warranted or not, depends on hard and costly analysis after the particular facts at hand.

Of course, the information asymmetry is recognized by the financial sector and regulation is in place.[6] However, compliancy with regulation is by itself not sufficient to generate trust and annihilate the moral risk – at best it ensures legal immunity. Being legally immune however, will not make indignation go away – perhaps to the contrary because the referral to the typeset 8'' texts provokes classical reproaches about "tiny print". And neither does mere compliancy function by itself as a competitive advantage that can be communicated in order to attract customers and promote business. So, regulation notwithstanding, the engineering, distributing and servicing of financial constructs offers good territory for practicing "corporate social responsibility", i.e. for the discretionary management of moral opportunities and risks that are not covered by mere compliancy with current regulation.

"Socially responsible investors" try to identify banks that discharge their responsibility in a superior manner; they shun banks that behave badly and look for the best-in-class banks. When they do, two paradigms are in vogue (Leys 2003). The one paradigm considers bankers as the politicians of economic development: by granting credit and by orienting investments, they shape our ecological, social and economic conditions and determine our future. Hence, their social responsibility consists in financing wind farms and in boycotting of projects that pressurize the environment.[7] The second paradigm considers bankers as managers of trust. Hence, their social responsibility consists in struggling successfully with the information asymmetries mentioned above while intermediating liquidity, solvency and other financial variables. The paradigms differ in identifying the social responsibility of bankers and thus the identification of banks that are (most) eligible for socially responsible investment. In practice, they intermingle.[8]

[6] For instance, in Europe, the MiFiDirective imposes on bankers the duty to complete an investor profile before advice can be given and purchasing can be contracted; also, the directive enlarged the duty of bankers to inform customers about costs and risks. In actual practice, techniques and modalities for determining "the investor profile" differ considerably between banks. By itself, that diversity does not constitute a problem but it does not help multi-bank customers to see things more clearly.

[7] Typically, this paradigm lives with NGO's that want to change the course of development through pressurizing banks when they cannot obtain their objectives through democratic political means. See for instance www.banktrack.org.

[8] See for instance the criteria used by the largest screening agency on the European continent, www.vigeo.com. When assessing banks, investment policy is considered, but treatment of customers and reliability of products is too. See Van Braeckel 2005 for weighting considerations on both.

Against that background, we analyze the responsibility of the distribution function in banking, more specifically the catering of financial constructs to retail customers, taking a type of structure that goes by the general name of "reverse convertible bond" (RCB) as our material focus.

The analysis is at two levels: the first is regarding the professional ethics, comparable to the professional ethics of the lawyer or physician (cf. note 3). The second is regarding the additional circumstance that distributors do not perform as independent professionals. Contrary to physicians, their practice is part of profit oriented corporate activity and the corporations in which they serve as officers manage a lot of activities besides retail distribution; this level of analysis may be qualified as corporate ethics.

First, we analyze RCB s and show that they may be represented in different ways; they are poly-paradigmatic and may be performed by distinct and diverging speech acts (section 2). After establishing a clear understanding of the construct without going into the mathematics too deeply, we analyze the strategic and tactic options for the marketing of these constructs. We ponder which options are to be preferred by (more) responsible bankers-distributors (sections 3-5). We then focus on the conditions in the corporate organization that enable the retail banker to discharge his responsibilities to the best of his ability (section 6). Section 7 then, addresses the question how a socially responsible investor may look upon the RCB-phenomenon and its treatment by banks.

2. **Convertible and Reverse Convertible Bonds**

As one might reasonably deduct from its label, a "reverse convertible bond" is the opposite of a "convertible bond". A convertible bond is a hybrid instrument in corporate finance: in some circumstances corporate management prefers not to issue stock but rather a bond that might be conversed into stock at a future date. During the bond-period of the construct, interests paid are deductible expenses for the corporation. Moreover, the rate on the convertible bond is (everything else being equal) lower than the rate on a plain bond, because the bond holder also receives the option, but not the obligation, to converse the bond into stock at a specified ratio, say 40 shares for one bond, at a specified later date. Of course, the purchaser of the bond will exercise this option only when the conversion price of the stock is lower than the then prevailing stock price.[9]

Most if not all manuals on corporate finance refer to this financial technique, yet treatment and appreciation differs. Most authors inform their readers, i.e. future Chief Financial Officers, that the complexity of this structure by far exceeds the complexity of issuing ‘plain’ bonds due to the combination of straightforward interest rates (composed of risk free rate plus risk premiums) with a(n) option(s) to reverse the bond into stock and with options to recall the bond at predetermined points or periods in the future. All authors refrain from explaining the instrument in full because “too difficult from a mathematical point of view”; Kaen states bluntly that “why firms issue convertible bonds remains a perplexing question” (p.581). Brennan and Schwarz signal very appropriately that some of the reasoning in the general answers to that question is fallacious because it compares the bond with shares in one scenario and with plain vanilla debt in another. To most experts, agency theory seems the best way to explain the use of the instrument (Kaen, Brennan and Schwarz, Vernimmen): the corporation grants a conversion option to bondholders in order to hedge them against being expropriated by shareholders as those are liable to augment the business risk after issuing a plain bond. This explanation feels uncomfortable because it describes corporate management playing games they are not aware of themselves and according to a theory that was not yet conceived when the first issuing of the structures occurred, sc. in the midst of the 19th century. Moreover, it fails to explain why not all corporate bonds are convertible bonds. Fallacious reasoning seems thus a more plausible explanation than superior intelligence in agency theory. This is not to say that convertible bonds have no legitimate existence in financing corporate activity – it does show that they are difficult to understand for corporate finance professionals and theorists alike and that assessing particular cases demands considerable intellectual effort.[10]

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[9] Brennan and Schwarz (1992) in the *New Palgrave Dictionary* that contains no lemma “reverse convertible bonds” or “reverse convertible securities”. As a matter of fact, we found no references in academic literature to this type of instrument.

[10] Although convertible bonds are a genuine instrument for financing corporate activity, complexity may be considered as a risk factor by itself. *The Economist* signaled a wave of litigation regarding so called “death spiral” convertibles (or “toxic convertibles” or “floorless convertibles”) that were popular in the late nineties. Unlike ‘plain’ convertible bonds, these could be converted into shares at a discount to the share price at issuance, not at a premium. Neither did they converse into a specific number of shares but into a fixed amount – so the lower the share price, the more shares the purchaser could obtain (NN). *Business Week* signaled “contingent convertible bonds”, in the conditions of which a contingency clause was inserted merely in order to optimize accounting presentation and tax issues (improperly), to the detriment of current shareholders that were confronted with higher and particularly in-transparent dilution risk (David).

The “reverse convertible bond” combines the same types of financial variables: interest rates, stock prices, options modified by call options. The opposition with the convertible bond is not between what types of assets are to be converted; in both cases it is debt that is converted into equity. The opposition is rather between *which party* has the right to converse and thus between the circumstances that make conversion come about. The *holder* of the CB will converse the bond into equity when the prevailing price of equity on the stock market exceeds the prevailing price of the bond. Inversely, the *issuer* of the RCB will converse the bond into equity when the stock price is lower than the price of the bond. This is to say that the issuer of the RCB has bought a put from the bondholder. He pays for this put option by offering a higher interest rate on the bond compared to a plain bond. As we will see, the difference in nominal rates may be considerable.

Of importance to note is that, whereas the CB originates out of considerations of corporate finance, the RCB is either a simple bet between two investors or originates in considerations of portfolio management (we will come to the difference between the two in section 5). Its existence is therefore more easily explained than that of the convertible bond.

Precise data about the issuance of RCB s are not easy to come by. For Belgium, the prudential authority, the CFBA, reports following figures for bonds with risk on principal: 3,2 billion euro (2000), 1,3 billion (2001), 1,5 billion (2002), 0,3 billion (2003), 0,3 billion (2004), 0.5 billion (2005), 1,1 billion (2006), 1,3 billion (2007).[11]

Now, let us turn to some real life reverse convertible bonds in order to illustrate the offer that is made to retail customers by some distributors of financial services. We quote a national quality paper that published a survey of “the banks product offering” at the beginning of April 2008 (Coppens 2008). In a two-page article, the journalist provides a comprehensible and neutral review of the active offering by six large retail banks. Two of them actively promote the purchasing of RCB s by retail customers. The author captures them aptly in his subtitles: “Deutsche Bank invites to bet on Fortis” and “Fortis

[11] Source: NBB, *Statistisch Tijdschrift*, 2008 II, 17.1.4. This category no only comprises RCB s but also bonds of the type mentioned in note 12. However, the bulk are RCB s. Emission volumes seem to take a dive after the stock market crash caused by the dot-com bubble and to go up before the stock market crash triggered by the subprime crisis. This fits with the insurance paradigm: one seeks insurance before accidents might happen; when they have happened, insurance is superfluous. The volumes surpass the volumes of retail bonds issued by the Belgian government except for the years 2003-2005 (ibidem). Investors seem to prefer risk free bonds after a crash a crash and their risk appetite augments with the passing of time and thus the approach of another downturn of the stock market.

proposes to bet on Dexia".[12] The author describes the structures and leaves no doubt about the risk involved for the purchaser. Let us take a closer look at the structures on offer:

- Deutsche Bank launches "Autocall Fortis":
  - this bond has an annual coupon of 18%,
    on condition that the stock price of Fortis does not hit the level of -40% compared with the stock price on Wednesday 4/2/2008 during the year. If it does, the annual coupon is 0%.
  - the term of the bond is 5 years,
    but the issuer will call the bond at coupon date if the stock price is unchanged or higher than the stock price on Wednesday 4/2/2008.
  - the outlay / principal is subject to a conversion into common stock of Fortis at maturity if and when the price of the stock is below the 40% level.
- Fortis puts a "Phoenix Note on Dexia" on display:
  - This bond yields an annual coupon of 11%,
    on condition that the stock price of Dexia during the year does not hit the -50% level compared to the stock price at launch date; if it does, the coupon is 0%.
  - The term is 5 years,
    but the issuer will call the bond at coupon date if the stock price is unchanged or higher than the stock price at launch date
  - At maturity, the principal is subject to conversion into common stock Dexia if and when the price is below 50% compared to the price at issue date.

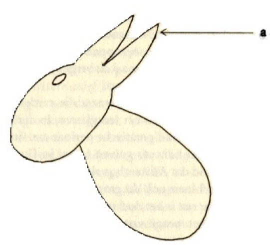
One does not have to understand all the mathematics involved in pricing the structure. We do note that in these particular structures not only the principal but also the interest payments are at risk, which complicates assessment even more and surely makes the instrument more aggressive. Possible outcomes, though, are simple: either the investor purchased a high yielding bond for a short term (best case) or he receives no interest at all and he buys shares at maturity at a price at least double than the current and the then prevailing market price (worst case). Also, it is obvious that the forecast by the issuing

[12] Coppens also points out that "KBC provides fairly aggressive advise" by promoting a bond of which interest payments and principal depend on the default risk of Belgium, France, Spain, Italy and Greece taken together. Axa, Dexia and ING are portrayed as more defensive in their offerings.

party is quite gloomy because it is willing to pay a very high coupon in order to obtain the option to converse the stock into cash at such a deep level.

In the introduction, we indicated that financial constructs may be considered as chains of speech acts. The concept speech act is easy to understand – it is activity by persons or by institutions such as promising, assuring, warning, proposing, informing, guaranteeing, inviting, forecasting, … Speech acts that constitute financial constructs are usually quantified and they have grown into prospectuses of several hundreds of pages.[13]

RBC s are, like many financial constructs, poly-paradigmatic. What we mean by this is that they are explainable or rather "performable" or "speech acted" in several ways. Compare this with theater productions: they can be 'staged' in several ways and still be conform with the script by the dramaturge. Rather than providing elaborate definitions of "paradigm" and a lot of references we show what we mean by using a picture (picture 1).



Picture 1

The picture may be explained or speech-acted as if it were a rabbit (paradigm A) or it may be speech-acted as if it were a duck (paradigm B). Both can be done with equal plausibility though you can not "see" them in one single view.[14] When we do the same trick with RCB s, the two speech acts go as follows:

A. (Rabbit) You buy a bond with high yield. On top of the risk free rate (government debt with the same maturity), you earn a premium for credit risk, a liquidity premium and a specific risk premium related to the volatility of the underlying stock of bank X (50% down – which seems very unlikely to happen).

[13] The prospectus of the Phoenix Note is 283 pages and is complemented by other documents that describe the actual financial variables that are fixed after the issuance of the prospectus. Shorter, accessible documents are also provided but they always refer the purchaser back to the prospectus and invariably claim not to be investment proposals.

[14] We borrow this instance of the duck-rabbit picture from Koningsveld (p.170). The arrow points to the ears of the rabbit/to the beak of the duck. If you are unable to see and interpret the picture alternatively as a duck and as a rabbit, close your eyes and try again. If you do not succeed after three times, better stop reading this article.

B. (Duck) You write an insurance premium regarding the evolution of the stock of bank X. In order to be eligible as an insurer you have to be able to deposit a guarantee, a bond. That is your principal, for the intermediate unavailability of which, you are, of course, to be remunerated by obtaining the risk free rate, a credit risk premium, and a liquidity premium.

Both A and B are "true". Yet, they sound as utterly different as if we were describing ducks and rabbits. The core of presentation A revolves around a high yielding bond-investment; the core of representation B revolves around the insurance of a particular instance of stock market risk.[15]

In the light of this ambiguity, we did *not* put the following to empirical testing but we feel sufficiently confident to put forward that:

a) The duck is less likely to grow into a commercial hit whereas the prospects of the rabbit are much more promising.

b) Most retail customers do not understand that the RCB-construct is poly-paradigmatic. That is to say: they are not sufficiently knowledgeable about finance so as that they would be able to construe A and B all by themselves. Indeed, this would presuppose education in finance as well as the motivation to deploy this capacity. Instead, most people are likely to trust their banker on this. Customers seldom read prospectuses (cf. Boatright, pp.64-65).

c) The number of retail customers that is actively looking for a bond with such and such maturity, function of such and such a volatility risk on the stock of this particular corporation X, is extremely low. Thus, the purchasing of a particular RCB is pushed, rather than pulled. More customers are likely to visit their banker with the demand for a 'high coupon' than there are customers eager to earn an extra by writing premiums on volatility-levels of a particular stock. This is to say that they are led by 'greed'.

We feel sufficiently comfortable with those three claims because they stand to reason. If ever empirical testing would prove them to be largely false we still maintain that our analysis is pertinent although relevance for practice would be a lot less. All we need for relevance is the hypothesis that *some* members of the public focus on the high coupon; lack education, skills and instinct to lucidly judge the offer of RCB s and are being approached by bankers rather than the other way round.

[15] RCB s on the general stock market or rather on a segment ("indices") have also been issued though the majority is on individual stocks.

3. **Strategic and tactical options in retailing Reverse Convertible Bonds**

If there are such members, the distributor of financial services has some considerations to make. How to treat these RCB s? How to speech act them to the customers?[16] Many options are open: not selling them at all (i.e. the speech act of keeping completely silent) and even referring customers that insist on purchasing it to competitors; discouraging sales by various means (e.g. by holding RCB purchases not eligible for sales incentive schemes, by comparative pricing), selling them passively (sc. only at explicit and unprovoked customer demand); to promote them actively (sc. to create demand by promotion). As we take an Aristotelian approach to business ethics, we feel that there are no general rules or norms to be put forward because the particulars of each situation defy generalization. Imagine for instance a distributor with a clientele that has a proven and very lively risk appetite and is very experienced in the selling and buying of options, warrants, futures and so on. These particulars differ widely from those of a retail banker that not even distributes equity funds and caters to a clientele that largely prefers simplicity in finance. Commercial positions are different and so are responsibilities. Thus, our analysis may be useful for practitioners as a tool rather than as a set of attitudinal prescriptions or universal instructions. We do not presume to tell bankers "what to do" but rather to promote enhancement of practices by elucidating and persuading – as Aristotle did in his main works on ethics. Nonetheless, we may also safely assume that all genuine distributors have some traits and interests in common. For instance, none of them prefers to loose customers now or in the future; all of them are interested in longer-term partnership rather than in one shot – transactions with strangers that happen to pass by. Also, distributors have responsibilities *qualitate qua* (e.g. MiFiD in Europe, note 5) and they want to be perceived as discharging those responsibilities and being a very competent service provider on top of that. So, there is scope for some general considerations and for the assessment of courses of action.

[16] Of course, he is bound to be compliant with prudential regulations about informing customers. All the information bearers we scrutinized duly mention the main risks involved, sc. the possible occurrence of the worst case scenario, and this even several times over. Yet, the presentation of the structure as a "bond" entails some connotations that are unwarranted. Also, we have found one instance in which the distributor presents the structure as "a RCB that does not necessarily have to be a RCB", thereby creating confusion between the actual contract (the selling of the option) and a possible outcome (the option being out of the money). Also, some texts put that the issuer "*may* convert if …" rather than that he *will* convert. We feel that regulation of communication and information providing is sufficiently developed but that, without the good faith and the best intentions of the bankers involved, it necessarily remains sub-optimal or even ineffective in protecting customers.

Given our empirical claims or hypotheses above, to actively promote RCB s is a fairly risky course of action. Moreover, the commercial risk is asymmetric. *Caveat emptor* indeed, but the purchaser (and even the salesperson) is at the lower end of the information asymmetry. If all goes well, the 'bondholder' is merely 'satisfied' and perhaps still unaware that he actually earned an insurance premium (rather than to have lost it by having to pay indemnities). If things go wrong with the stock of bank X, those customers are likely to claim that they were being misled, kept in the dark about the risk, … without regard to the fact that all legal disclaimers have been duly signed. They might go into cognitive and moral shock when, suddenly, the veil of information asymmetry is lifted and they start hearing a duck quacking instead of caressing a loveable rabbit. Perhaps they are even unable to remember that they once believed to buy a nice and gentle rabbit and that they had been informed about the possibility of it suddenly becoming a dead duck. Such would be all too human and the legalistic formulas are unlikely to be effective chants for evaporating indignation and emotional difficulties with absorbing an (unexpected) loss. If and when such customers would be numerous (cf. the active promotion strategy), they even might form a coalition, possibly supported by or sourced out to professional consumerist organizations. Active promotion of RCB s thus carries considerable risks. In business terms, those risks have to be compensated for by higher fees or legitimated by the loss of customers that are attracted by competitors that (also) actively promote the structures. Higher fees, i.e. compared to other investment vehicles, might cover the risk from a strict business point of view or so it might be thought. Yet, when the worst case occurs and when things come to the crunch, these comparatively high fees are more likely to be a liability. One can easily re-interpreted them and use them as an argument about the motivation of the active distributor, by saying he actively distributed the now unhappy instruments because he stood to gain more (at the expense of his trusting customers). The higher the fees, the more likely that they cover commercial, reputation and legal risk, yet the higher the moral risk, viz. the risk to be seen as non-respecting the genuine interests of consumers.

At the other end of the range of attitudes and tactics, a distributor might outright refuse to sell the instruments. He then incurs the risk of being perceived as paternalistic, backward, jealous about high yielding opportunities, and so on. By not having those instruments available for sale, he stands to loose business deals and even customers. So, without further ado, this option is not open to a distributor that claims to be a "universal bank". The least he can do is not to put the RCB in the window and obligingly serve the customer who spontaneously asks for it.

As already mentioned, distributors have numerous options in between the two extremes of outright refusal to service and active promotion. Instruments of corporate management to implement these options are numerous: incentive schemes for the sales force, internal warnings, presence / absence on lists of instruments for sale, restriction of personnel that is allowed to contract the purchase and so on. These are all internal marketing tools, sc. internal to the banking corporation.

An external marketing tool is visible for customers and perhaps promises more effectiveness in the managing of risk and opportunity that originates in RCB s being around for purchase. Such a marketing tool should attack the information asymmetry beforehand and very forcefully. It should position the distributor as a very knowledgeable and genuinely caring about the financial and psychological wellbeing of his customers. On top of the legal documentation and the regulated leaflets, the distributor could write out a speech act for the customer and have this signed. It could run as follows:

> *My banker, A B, and I have sufficiently spoken and discussed about the bond I am now going to purchase for x% of my financial assets.*
>
> *I understand that I will be insuring a counterparty against the risk of the stock price of C falling below 50% of the current market price. For that, I earn an insurance premium of y%. As a consequence of me insuring of that risk, the outcome of the transaction may be that, at maturity, I buy y stock of corporation C at a price that is at least double of the then prevailing market price.*
>
> *I do realize that the party at the other end of this insurance deal wants to be absolutely sure that I will be able and willing to pay for the shares at that moment and in those circumstances and conditions. Therefore, it asks me to deposit a collateral, which is the principal of the bond. I understand and accept that this is the necessary condition for earning the insurance premium.*
>
> *Contrary to this other party, I am convinced that his fear will not come true and the risk will not materialize, so I bet the better part of my principal on the stock of C.*"

This speech act implies that commercial strategy of the distributor is rather passive and that the individual employee that serves the customer is also made responsible. By erecting a hurdle to uninformed purchasing, i.e. by lifting the information asymmetry, the distributor will discourage a lot of prospective buyers – but he will not loose their trust or custom. Instead, he discourages sales at one point in his gamma in order to be more eligible and trusted as an advisor and as a provider of a whole gamma. Perhaps the customer purchases another investment; perhaps he buys the RCB. In that case, no person that is legally able to sign contracts could afterwards claim that he was kept unaware by his banker. Even the lucid investor with a huge appetite for risk who does buy will be satisfied that his interests had been taken duly care of in the process, albeit a bit paternalistically. Afterwards, he may be disappointed when the stock price implodes but he will not be dissatisfied about the services of the distributor. His custom will not be lost; trust will remain intact.

By way of conclusion, we may summarize our findings as follows: a lucid understanding of the RCB yields the opportunity to surpass the compliance level and to diminish residual moral risk. The technique of speech acting the construct as an insurance with collateral rather than as a bond with high yield may be rather brutal and therefore redirect purchasing to other instruments available. In the process, customer dissatisfaction risk is completely mitigated and moral and technical superiority may be shown without hurting business interests.

4. From a defensive approach to surpassing customers' expectations

In the previous section, we arrived at a level of ultra-compliance regarding customer information. In this section, we go one step further and we ask whether the offer can be enhanced and we will show that indeed, it can. When the veil of paradigmatic information asymmetry is lifted and additionally some factual information asymmetries are lifted too, the target market for RCB s shrinks to a minimum.

First of all, the Belgian fiscal administration opts for the bond-paradigm. The yearly cash flow is qualified as interest rather than as a premium earned. Hence, 15% withholding tax is applied. Yet, when the downside risk occurs and the subscriber of the bond looses his premium and even part of his principal, his taxable income is not reduced. Therefore, even if pricing would be without margins, fees and costs and thus conform with the 'mathematically correct price', his risk is asymmetric: when he wins the bet, he pays taxes; when he looses the bet, he can not deduct the loss from his tax base. This goes contrary to the instincts of the famous Belgian dentist and it may apply in other jurisdictions too.

While this feature may hold solely for Belgians and the fiscal asymmetry may be absent in other jurisdictions, there are other secondary features that are valid for all investors and distributors. Secondary liquidity during the holding period is likely to be rather low because the number of investors actively seeking to purchase a bond with such and such features will be near zero. There will be no continuous trading in these instruments then. So, bondholders that want to sell will have to accept quotations as given. These quotations are not that easy to assess by lay men because of the many factors that are involved (cf. above): yield to maturity in the bond market, creditworthiness of the issuer; volatility and level of the subjacent stock price. We have seen that minimal and maximal scenarios are easy to discern but intermediate marking to market of the complex structure is extremely difficult; it may even be considered gratuitous in the choice of variables regarding volatility. Thus, the intention of the informed purchaser must be to buy and hold. Yet, the typical buy-and-hold purchaser of bonds is the investor the least likely to bet on stock volatility.[17]

Now, the prospective purchaser of the RCB bets on the scenario that stock X may well go down but will never touch the -50% level and he is convinced that he will earn his insurance premium. He is well informed and well aware that tax treatment is asymmetric and that secondary liquidity in markets is non existent. Perhaps then, he may find a way to bet more effectively on the said scenario, i.e. with less risk for initial outlay, with more secondary liquidity, with more options, more simply. Of course, infinite alternatives are conceivable so we stay close to the underlying scenario. A lucid and well informed investor may explore the following route:

First: he subscribes to a zero bond so that his capital is intact at maturity, which is to coincide with the maturity of the RCB.

Then he may use the difference between his presently available sum and the value of the zero bond use for betting on the scenario. For the moment, it is put aside.

Finally, when the price of stock X nears -50% he may decide to buy call options on the stock or to buy long warrants. He may even be more careful or defensive and buy the call options or long warrants when the price of the stock *has passed* the -50% level.

In the worst case, he may loose his call premium or his warrant completely, but he will never be hurt in his principal. The maximum he stands to loose is the as-if interest on

[17] Again, we have not tested this empirically but it stands to reason and accords with common sense. Betting on volatility implies active attitude towards the evolution of stock prices; to buy and hold bonds is perfectly compatible with not being informed and even not interested in what happens on the stock market or even the bond market during the holding period.

his initial capital. If the scenario plays out as the bet was structured, he may gain the value of the interest on his initial capital many times over, thanks to the leverage in the warrant or the option.

This refinement yields many advantages compared to the initial position of buying a bond and writing insurance: capital loss is excluded; the writing of the insurance premium can be postponed and decided later on (which constitutes an option for the investor[18]); the liquidity of long warrants is high and nearly without interruption; the pricing of the components of the construct is much more simple and transparent; the components can be traded separately (which is an option too).

All of this seems to imply that when a lucid customer is proposed to purchase a RBC and he is positive about the scenario on which he is invited to bet, he is likely to look for alternatives – all he has to do is look for the building blocks and verify whether they are available. Of course, this entails some efforts on the part of the investor but, in general, informed investors are informed because they make efforts, sc. invest in learning and (re)searching. Realizing that he is to put 50% of his capital at stake, the lucid investor will be motivated to search. For the naive and uninformed customer on the other hand, the RBC is by hypothesis not suited at all.

Taken together, it seems that the prospective market segment for RBC s is rather small: it consists of investors that fully understand the construct but are too lazy to look out for instruments that may be better suited to reap the fruits of their bet (or contain the damages).

What does this imply for the management of risks and opportunities by the distributor?

It seems to imply that he is able to surpass the level of risk management we sketched in the preceding section, provided the building blocks for the alternative we sketched in this section are actually available in current financial markets. They are: universal banks issue zero bonds on tap and they offer interest bearing accounts for the amount that is put aside for buying the warrant or the option. They might not issue warrants on a continuous basis (in fact, most of them do not), they offer execution-services on most markets. Long and short warrants, commercially termed “turbos”, are continuously issued, in series, by ABN AMRO and traded on Euronext. At the moment of writing, April

[18] According to financial theory and concordant with common sense or intuition, options have always positive financial value. The fact that the investor is able to postpone his decision entails an infinite number of options: whether or not to purchase; whether or not to bet on stock X (instead of Y or Z; indeed: a knowledgeable investor sees beforehand that when bank X would quote -50%, bank Y is likely to quote much lower too); whether or not to diversify his risk by subscribing warrants on several stocks; and even to bet long or to bet short.

2008, 15 turbos on the Fortis-stock are traded, 5 of them long, 10 of them short. Pricing is continuous, the bid offer spread is 10 basis points and trading volumes are very considerable, specifically of warrants on the stocks underlying the RCB s mentioned. Thus liquidity is high and pricing is transparent.

Thus, it is very well possible to redirect the customer by lifting the veil of information about the actual availability of instruments and constructs to bet on the same scenario. As the proposed alternative (but in reality, the alternatives are infinite) is financially superior and even more convenient for the investor, more transparent and less risky, the customer has every reason to be satisfied about the constructive intervention of the distributor. Even if the warrant or option would eventually turn out to be valueless he may consider himself lucky that this unexpected event against which he was willing to make the bet in the first place, did not impact his principal.

So, the responsible and creative retail banker will conceive of alternatives for the RCB that are likely to satisfy customers more and will demonstrate -or show off, if you like- his superior capability as well as his good stewardship regarding the financial interest of his customers. In order to avoid all the risk that goes with letting information asymmetry exist on this alternative construction too, the banker should obtain assurance from the customer that he was not being actively proposed and pushed to invest in highly leveraged instruments but that he was informed about their usefulness in playing on scenarios, i.e. informed as a constructive response to his initial demand for “high yielding bonds”.[19]

Whereas the explanatory-strategy described in the preceding section only seeks to annihilate moral risks and shows the distributor to explain the construct in a superior customer oriented manner, the alternative-strategy annihilates risk too and shows the distributor to understand and able to better the construct. The execution of this strategy presupposes a high level of investment in human resources, sc. sales officers, operational marketing officers and communication officers. However, the incremental cost thereof, compared with the cost to explain and have grasped the nature of the RCB, may very well not be prohibitive at all. Offering RCB s presupposes that investment too! Incremental costs should be compared with the cost of moral risk and with the income generated by the straightforward selling of RCB s compared with the income generated by the selling of the alternative. The last may even be higher, depending on the margin

[19] Indeed, no such thing as a free lunch. This market of perpetual warrants has its own particular risks: declining value of long warrants during holding period, operational risk, unanticipated drying up of liquidity, for instance.

earned by selling bonds on tap and the transaction fees earned by facilitating the orders on the warrants. This calculation falls within normal business practice; the quantification and valuing of moral risk and CR-standing is less straightforward.

The good stewardship, the investment in the capabilities of salespeople, the developing of more customer friendly alternatives, the education of customers by lifting information asymmetries is what people associate with CSR in general. From the point of view of the investor, it is the successful avoiding of superfluous risks and the exploitation of opportunities.

5. Insuring against downward volatility of stocks

The insurance paradigm for the RCB points the financial ethicist to questions about moral hazard that go with the activity of insuring and the unequal distribution of information. Indeed, the *cas-the-figure* is identical to insurance of any risk whatsoever. An insurer will only accept the risk when he is able to assess it, preferably on a quantitative basis - which is, as we saw, nearly impossible for the retail customer to do in case of the RCB. Therefore, normally an insurer will ask all kinds of questions about business outlook regarding bank X, the financial sector in general and financial markets as a whole. Like any insurer, the customer should ponder these questions. He should also be aware that at the other end of the construct is a party that stands to gain if the stock prices hits -50%. That party, the buyer of the insurance, should be questioned as in any insurance contract. Indeed, there is one well-known exception to the general rule that a contracting party has no duty of disclosure to the other party. This is a distinguishing feature of insurance law and the obligation of disclosure is imposed not on the stronger party to the contract, the professional insurer, but on the party seeking insurance. Full unambiguous disclosure is required of all the material facts known to the insured (Borrie, p.55). But in our case, the insurer is the *weaker* party – we may, then, use the point of Borrie in an a fortiori argument: the insured party should disclose in full. The party seeking insurance is not present and even not known when the RCB is presented to the customer. Indeed, who is the final buyer of the insurance? This is not necessarily the issuer who may have originated the structure in a deal with a third party.

In general, we can imagine three types of party and we briefly analyze the particulars of each type. We look at two ethical questions, one regarding the information asymmetry at the moment of writing the insurance, one regarding the 'moral hazard' once the insurance is in place. The second refers to an eternal ethical question in insurance:

moral hazard arises when the insured party knows itself to be well insured. The existence and the knowledge of the insurance make it likely that the insured party will be less careful than when no insurance would be in place because the consequences of the risk occurring now have a diminished impact on his situation. In extremis, this could lead to complete indifference towards the risk – one step further, the insured party may prefer cash rather than absence of damage.

The first type of party is the most innocent: it is a party that wants to bet on the stock price of bank X but has no further interests in bank X at all. In this situation, the aspect of insurance is very weak – the insured party has no legitimate interest in the insurance because it is not affected by the decline of the stock price. So, two parties bet against each other, no party being more involved in bank X than the other. If none of the parties has any possibility to influence the outcome, sc. the stock price of bank X, the problem of moral hazard does not arise. This is a zero sum game between equals.

The second possibility is less innocent: the portfolio of the party that seeks insurance contains stock of bank X. This party is willing to pay the premium because it fears that the stock of bank X will indeed pass the level of -50% and it wants to hedge against this happening. This party is an institutional investor because the very idea, its implementation and the size of the transaction exclude ordinary retail customers. It may be a pension fund, an insurance company, a bank. So we are confronted with an institutional investor insuring himself with retail customers. This raises questions about the corporate responsibility of the institutional investor because it seems that intermediaries in the financial system are seeking insurance from non-participants. Such a situation is contrary to insurance instincts. First, the balance of knowledge about the financial system and what is happening in it (and might be expected to happen further on) is clearly in the advantage of the insured party.[20] Secondly, it is the weaker parties that insures the stronger party which is also contrary to normal insurance. Besides these anomalies, the question is whether financial intermediaries discharge their societal responsibility or their corporate purpose by exporting the risk they are supposed to carry

[20] A particular circumstance is that insurance is sought regarding stocks of *financial* corporations. Insiders are very conscious that financial stocks differ considerably from industrial or commercial stocks. Indeed, banks quoted on the stock market represent partially recurring commercial income, partly transformation income and partly a balance sheet that consists mostly of financial assets. The last represents nothing else than pure investment risk. Commercial and industrial corporations do not carry these features. Moreover, banks are liable to suffer bank runs – a horrible scenario, yet not unknown these days, that is compatible with stock prices declining with 50%. In some discourses, a commercial argument for the opportunity of the RCB is that bank stocks have, April 2008, already declined with considerable percentages – hence, the link with the Phoenix-label (cf. Coppens).

and manage. Indeed, why not simply sell off the stock? Clearly, if all institutional investors were to insure the risk of the stocks in portfolio, they do not add value at all on a macro basis. In this type of situation, the moral hazard problem might materialize. Suppose the institutional investor notices that the said stock quotes at the -49% level. Would it not be tempted to throw some on the market so that the put option comes in the money?

A special case of this type, would be that the bank that issues and distributes the RCB is also the party that buys the insurance. If so, there is a problem of consistency. The issuing department on the one hand feels that buying the insurance is a good investment. The retail department of that very corporation on the other hand, tells customers that granting the insurance is a good idea. Besides inconsistency at the level of the corporation, we have also the fact that the bank bets against its own retail customer base, which is very exceptional. It may resemble a “cleaning of the books” at the expense of the uninformed purchaser.

The third possibility is that the party that seeks insurance belongs to bank X itself. For instance, the management of bank X seeks to insure against the possibility that the stocks it holds take a deep dive. Any professional insurer would refuse to accept this proposal. Compared with the previous situation, the information asymmetry is no longer general but also particular. Who knows the situation and the prospects of bank X better than management itself? So, the risk implied by the proposal itself is too great for professional insurers to take it on the books. Why then, would retail customers take it on? Regarding the moral hazard problem, it should be remarked that insiders have additional means to influence the stock price besides selling; for instance, they might issue corporate communications that make the stock go down.

Thus, we see that the identity of the party seeking insurance might be material for decision making. The distributing banker is the professional that ‘buys’ the RCB in order to re-sell it to its customers. Hence, his responsibility resembles that of a professional insurer. That is to say, he has to try to answer the questions any professional insurer will ask himself before accepting a premium: who is paying the premium and why? The distributor thereby not only protects his customers he also protects his own reputation. Because, indeed, he would be a bit embarrassed to learn at a later date that it was the management of (say) Enron, Parmalat, Lernhaut & Hauspie or Ahold that had insured their private holdings with his customers.

By way of conclusion, we may state that the professional responsibility of the retail banker is to probe into the insurance structure as any professional insurer would do. It is his duty as an agent to do so on behalf of his principal, the retail investor, who is invited to insure. But it is also in his own commercial and moral advantage not to get caught up in constructs that, with hindsight, go against elementary principles of insurance.

6. **Corporate ethics: organizing for professional ethics**

The preceding sections deal with business ethics in the sense of professional ethics - remember the paradigm of the relationship between distributor and customer being the same as that of the medic and his patient. But actually, retail banking is not practiced as a liberal profession; it is an incorporated activity. Moreover, the corporation in which the retail banker is an officer, is likely to run other financial activities besides retail banking. So, at the level of the corporation, some measures need to be in place to safeguard the autonomy of the retail banker. Three such measures come immediately to mind: providing education, building Chinese Walls and installing whistle blowing procedures.

The providing of education is elementary. If the marketing and sales officers of the bank are intellectually not equipped to see the risks mentioned above they are not capable of discharging their responsibility at all.

Chinese Walls refer to internal regulation about the distribution of information and the autonomy of corporate departments. In our case, the retail banker should be guaranteed autonomous decision making about which RCB s to distribute (actively, passively) and which not. If the retail banker has no decisional prerogatives in this, he merely functions as the outlet for wholesale and financial market departments whose main objective is to service *their* customers. But, contrary to what is often said and practiced, the corporation may not interpret this Chinese Wall to work the other way around too. We have seen that the retail banker should be able to scrutinize the proposed structures in order to verify on behalf of his customer whether the constructs correspond with elementary principles in insurance. It pertains to corporate ethics then, that the financial services corporation should guarantee, by means of organizational policy, the competence and the empowerment for the retail banker to do so without hindrance or undue pressure.

A second instrument that should be in place is an internal whistle blowing procedure. In the case at hand, it entails that employees of the constructing and issuing departments are allowed (and even obliged) to signal irregularities, improperly handling of conflict of interest, to a third party in the corporation. The possibility of whistle blowing by itself functions as a restraint for improper behavior in these matters; for instance regarding situations of type three in the preceding section. We also imply that whistle blowing should not be restricted to signaling unlawful behavior; signaling conflicts of interest or simply the impossibility to exercise one's function to the full should also be covered. The absence of whistle blowing procedures with an internal recipient makes it the more likely that external whistle blowing occurs, which would put the bank in a less comfortable position.

Thus, in order to guarantee the possibility for the retail banker to discharge his responsibilities without undue hindrance the socially responsible financial services corporation will have installed organizational rules and principles. These measures too, aim at diminishing moral risk for the corporation as a whole. If and when they function well, the bank may deploy this feature as a competitive advantage towards retail customers. We see this already happening when some bankers communicate that they only distribute "the best products available in the market", whether they are made in house or not. Of course, this is a business model as any other but even when the bank positions itself otherwise and has only house made products on offer, the position cannot be that the retailer distributes constructs regardless of their intrinsic quality and possible impacts.

7. **Socially Responsible Investing and Reverse Convertible Bonds**

Socially responsible investment (SRI) takes into account non-financial attributes of investment opportunities. How then, should they look upon RCB s and the banks that distribute them? CSR-screening for SRI-investors is heterogeneous and there is a pluralism in methodologies and outputs. However, most if not all rating agencies assess the distributing bank on its approach and treatment of customers (cf. note ...). In section 3 and 4 we sketched the different options in policy and types of responsibility that a distributing bank may assume. Of course, rating agencies will not focus on the treatment of RCB s particularly - perhaps they are even unaware about the existence of such structures. But the bank may spontaneously inform the rating agencies when questioned about its customer relationship management. A bank that is seen to inform its customers in a superior manner and that actively develops more customer friendly alternatives will score some additional points in the CSR-rating. Such a bank is also more likely to develop superior customer oriented solutions on other topics and issues as well. In sum, the treatment of RCB s may function as an indicator for customer care and a predictive indicator at that.

The status or level of CSR displayed by the corporation of which the stock is subjacent in the RCB-construction we deem completely irrelevant. Whether or not that corporation is best-in-class in its economic sector or whether or not the corporation breaches basic social and environmental norms can not qualify or disqualify the RCB as an SRI-investment. The reason for this is quite simple and straightforward: the RCB is about the evolution of the stock price, not about corporate activity. As we have pointed out in section two, the RCB is not an investment that funds corporate activity. Moreover, no case can be made for the volatility of the stock price being an indicator for the social responsibility (or the opposite) of the corporation at hand and neither will responsible corporate behavior after the launch of the RCB function as an insurance against a decline of the stock price. On top of that, the investor will not be able to change the subjacent stock during the holding period as a reaction to corporate behavior that may disqualify as “socially responsible”. Hence, we see no reason at all to qualify or disqualify RCB s as SRI in relationship to the stock that is subjacent. The concept of “SRI – RCB s” is without any sense. To attribute SRI-status to RCB s would be deceptive marketing.

8. Conclusion

We analyzed the financial structure that goes by the general name of “reverse convertible bonds” and found that it may be presented as a high yielding bond with some risk attached to it and that it may be presented otherwise, sc. as depositing collateral in the framework of an insurance transaction. The retail banker has a wide set of opportunities in determining strategy and tactics regarding that phenomenon. They range from active promotion to outright refusal to sell. If he is enabled to act autonomously towards other departments in the bank, the retailer may find a way to mitigate the risk of information asymmetry and he also may develop alternatives that offer superior features for his customer. All of this is considered to belong to the domain of “corporate social responsibility”. The treatment of RCB s (and like instruments) may very well be used as an indicator of general policy towards customers that by definition are at the lower end of the information asymmetry. When assessing the way a banking corporation ensures or enables professional ethics of its retail officers one should also take a look at the organizational design and take into account the presence or absence of Chinese Walls and whistle blowing procedures. To all of this, there is a rather defensive aspect, i.e. mitigation of moral risks, but also a competitive aspect. Trust in finance is essential because 'products' are difficult and not destined for 'consumption'. So the banker who is able to augment trust by lifting information asymmetries and to come up with superior alternatives when confronted with customer demand, is –ceteris paribus- the banker that wins commercial competition. Because mere compliance with standing regulation does not offer any competitive advantage and because compliancy at best merely shelters for legal risk, it does not offer a safe harbor against numerous customers feeling misinformed or even cheated and uttering reproaches and accusations. Such is the nature of banking due to information asymmetries, particularly regarding complex structures such as RCB s. But in general too, the lifting of information asymmetries is a constructive business move and goes to the core of the social responsibility of the 21st century professional. As a famous business ethicist once formulated: "the first social responsibility of the manager today is to make understandable to the layman –the educated people who are outside of business and necessarily ignorant of it- what it is that business does, can do and should do, and what it is the manager is doing." (Drucker, pp.226-227). This seems to apply the more so when the layman is nearly illiterate in the matter at hand and by 'purchasing' a 'product' becomes a party in a chain of speech act constructs rather than enjoying material goods. Hence, banks that show superior capability in managing the RCB – phenomenon are –ceteris paribus- eligible for SRI-investments.

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